INFORMATION BULLETIN

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Changes to the issuance limit imposed on Capital régional et coopératif Desjardins and to the limit relating to the deductibility of investment expenses

This information bulletin describes the application details of the issuance limit imposed on Capital régional et coopératif Desjardins for the capitalization period beginning March 1, 2005 and ending February 28, 2006.

It also describes changes made to the limit relating to the deductibility of investment expenses, in particular by introducing a transition period for deductions relating to resources arising from the acquisition of flow-through shares.

For information concerning the matters dealt with in this information bulletin, contact the Secteur du droit fiscal et de la fiscalité at (418) 691-2236.

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Finances Québec

Change to the issuance limit imposed on Capital régional et coopératif Desjardins

Capital régional et coopératif Desjardins is an investment company with the mission of raising venture capital for the benefit of the resource regions of Québec and the cooperative sector.

Since the creation of this investment company, the government has supported its mission by allowing it to collect, for each of its capitalization periods, capital enjoying a tax benefit. This tax benefit consists in allowing, for individuals who acquire shares of this company, a non-refundable tax credit equal to 50% of the issue price paid for the shares, up to a total tax credit of $1 250 per year.

Under its act of incorporation, the paid-up capital of the issued and outstanding shares of Capital régional et coopératif Desjardins – limited to $475 million as at February 28, 2005 – can grow by $150 million for any capitalization period beginning after such date, reaching a maximum amount of $1 375 million at the end of its last capitalization period, which must end on February 28, 2011.

As was the case last year, the government's participation in the growth of Capital régional et coopératif Desjardins will be reduced by 33 ⅓% for the company's capitalization period ending February 28, 2006. Accordingly, the growth in the authorized capital of this investment company will be limited to $100 million for the capitalization period that began March 1, 2005 and ending February 28, 2006, bringing its authorized capital, by the end of such period, from $625 to $575 million.

Moreover, in the event that the paid-up capital of the issued and outstanding shares of the capital stock of Capital régional et coopératif Desjardins exceeds $575 million on February 28, 2006, the company will have to pay, no later than May 31, 2006, a special tax of an amount equal to 50% of such excess amount.

For greater clarity, for a capitalization period ending after 2006, the paid-up capital of the issued and outstanding shares of Capital régional et coopératif Desjardins may again increase by $150 million per capitalization period, reaching a maximum amount of $1 325 million on February 28, 2011.

The following table shows the maximum amount that the paid-up capital of the issued and outstanding shares of Capital régional et coopératif Desjardins may reach up to February 28, 2011.

MAXIMUM AUTHORIZED CAPITAL
(Millions of dollars)

CAPITALIZATION PERIODS	MAXIMUM CAPITAL
From March 1, 2005 to February 28, 2006	575
From March 1, 2006 to February 28, 2007	725
From March 1, 2007 to February 29, 2008	875
From March 1, 2008 to February 28, 2009	1 025
From March 1, 2009 to February 28, 2010	1 175
From March 1, 2010 to February 28, 2011	1 325

Adjustments to the limit relating to the deductibility of investment expenses

Under existing tax provisions, an individual may deduct, under certain conditions, the expenses he incurred during a taxation year in order to earn business or property income.

However, since the expenses incurred to earn property income are expenses attributable to the realization of passive income, and considering that it is desirable, from a fiscal policy standpoint, to achieve a degree of symmetry between the flow of income from the investments held and the expenditures incurred to earn such income, a measure limiting the deductibility of investment expenses was announced in the March 30, 2004 Budget Speech, completing the general provisions on the deductibility of expenses.

Accordingly, for a taxation year, the deductibility of investment expenses incurred by an individual[1] is now limited to the income from such investments realized during the taxation year. However, investment expenses that cannot be deducted in such taxation year may be carried over against investment income earned in one of the three preceding taxation years or in any subsequent taxation year, provided the investment income earned in any of these years exceeds the expenses then deducted.

In order to take account of a degree of ambiguity that may have existed regarding the items covered by the notion of investment expense and to recognize certain special situations relating to the notion of investment income, adjustments will be made to the limit relating to the deductibility of investment expenses.

1 For the purposes of this measure, an individual also means a personal trust.

❑ Notion of investment expenses

Briefly, except for losses resulting from the rental of an asset, the investment expenses considered in calculating the limit on the deductibility of investment expenses include the items otherwise included in the calculation of the cumulative net investment loss (CNIL).

The wording of the *Additional Information on the 2004-2005 Budgetary Measures*, concerning the notion of investment expense may have given the impression that certain items, though included for the purposes of the CNIL, do not constitute investment expenses for the purposes of the limit relating to the deductibility of investment expenses because they were not specifically mentioned in the description of this notion. Such is the case, for instance, for exploration expenses and development expenses incurred in Canada, except for such expenses incurred in Québec, that have been foregone in favour of an investor under the flow-through share system, 50% of which constitute investment expenses for the purposes of the CNIL.

Since such flow-through shares are generally issued in the course of a public offering, which requires disclosure of various tax information to investors, certain prospectuses filed since the introduction of the measure would not have contained information on the possible application of the rules relating to the limitation on the deductibility of investment expenses.

Accordingly, to avoid any prejudice to investors, flow-through shares issued either after a placement made no later than the publication date of this information bulletin or following an application for a preliminary prospectus certificate or prospectus exemption, as the case may be, filed no later than such date, will not be covered by the rules relating to the limitation on the deductibility of investment expenses.

❑ Notion of investment income

An individual who realizes a capital gain on the disposition of eligible small business shares, eligible farming assets or eligible fishing assets, may claim a cumulative exemption of up to $500 000 of such capital gain.

Moreover, as it is the case for the notion of investment expenses, the investment income included in calculating the limit relating to the deductibility of investment expenses includes items otherwise included for the calculation of the CNIL, with the exception, however, of income from the rental of an asset. Accordingly, taxable capital gains that are ineligible for the capital gains exemption constitute investment income both for the purposes of the CNIL and the limit relating to the deductibility of investment expenses.

According to the existing tax provisions, taxable net capital gains realized by a trust and attributed to a beneficiary of such trust are not considered investment income for the purposes of the CNIL and the limit relating to the deductibility of investment expenses, even though they are otherwise ineligible for the capital gains exemption.

In addition, according to the existing provisions, the portion of the capital gain eligible for the exemption in excess of the $500 000 threshold does not constitute investment income for the purposes of the limit relating to the deductibility of investment expenses, even though the tax treatment of such excess is identical to that of any capital gain that is ineligible for the exemption, since it must be included, at a rate of 50%, in the calculation of the individual's income.

To correct these situations, two changes will be made to the notion of investment income for the purposes of the limit relating to the deductibility of investment expenses. First, this notion will be changed to include taxable net capital gains attributed by a trust to a beneficiary of such trust that are not otherwise taxable capital gains eligible for the capital gains exemption. Second, the notion of investment income will be changed to include the taxable portion of capital gains eligible for the capital gain exemption that exceed the $500 000 threshold.

These changes will apply as of March 30, 2004.